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ASSESSMENT OF THE BEIRUT STOCK EXCHANGE AND RELATED ENVIRONMENT

Final Report

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EXECUTIVE SUMMARY

The overall conclusion is that although the capital market in Lebanon is currently illiquid, there are possibilities for the future. In addition, if the Beirut Secondary Market's ambition to become a commodities, bonds and financial futures market is realized, it could become a principal regional exchange in the future. There appears to be no shortage of investors wishing to invest in Lebanon - only a shortage of securities to trade. Technical assistance is needed in the areas of regulation and in providing advice and assistance to the Beirut Stock Exchange and the Beirut Secondary Market. The following are the principal points emerging from the report:

1. The by-laws of the Beirut Stock Exchange (BSE) are consistent with what should be expected of a Stock Exchange Act.
2. The BSE's systems, although adequate for present volumes and market conditions, are incapable of modification to support remote access.
3. The French government, through technical assistance from the Paris Bourse, has offered a new automated trading system (PRISM 96). However, no work has been carried out in specifying the BSE's requirements for such a system.
4. The BSE should delay a decision on the acceptance of PRISM 96.
5. There are no risk management systems in place, but this is largely irrelevant at present because of low volume and the requirement to lodge cash and securities up front.
6. Four securities are listed on the BSE, but only one is traded on any regular basis.
7. The shares of Solidere transfer from the Beirut Secondary Market (BSM) to the BSE at the end of September 1996. Although this will greatly increase volume on the BSE, it will have no overall effect on market liquidity.
8. A number of companies that have raised capital outside the stock exchange may apply to the BSE for a listing in the future.
9. Banks are now permitted to issue up to 30% of their shares without prior central bank approval and are likely to apply for a listing on the BSE.
10. Other potential listings include insurance companies, privatized industry, and companies involved in the tourism and leisure industry.

11. Most companies issue bearer shares which are traded outside the BSE.
12. An increasing number of companies are raising capital by bond issues which are more attractive to Lebanese investors.
13. Overall liquidity on the BSE is declining due to a number of factors, including:
 - Lack of a sufficient number and spread of securities to trade;
 - Companies that are listed are tightly held;
 - Because many of the companies have issued bearer shares, trading takes place in the 'grey' market off-exchange;
 - Lack of international accounting standards;
 - Lack of accurate and in many cases any company information;
 - Interest rates are high whilst returns on equity investment are low;
 - There is no on-exchange bond market. Bonds are generally issued off-shore;
 - There are a small number of investment funds aimed at off-shore investors and high net worth Lebanese investors but none geared to the retail investor;
 - Lack of public awareness;
 - Poor market visibility;
 - Lack of awareness at the BSE regarding what steps to take to try to improve liquidity;
 - Lack of sufficiently trained and qualified people within some, but not all, brokerage firms.
14. There are currently 8 member firms of the BSE, and this is scheduled to rise to 12 by the year end. However, Lebanon is suffering from a lack of instruments to trade, not a lack of investors or investment institutions.
15. The decision to allow banks to be members of the BSM will require reconsideration if the BSM's ambition to become a commodities and financial futures market is realized.
16. There is no licensing or examination of people working in the Lebanese securities industry.
17. The staff of the BSE will require extensive training to take over the role of market regulator under the new securities law.
18. The BSE needs to experiment with its trading procedures and market rules in an attempt to increase market transparency and liquidity.
19. The BSE should consider the introduction of a limit-order-book and a specialist system similar to the American Stock Exchange or the "Hoekman" in Amsterdam.

20. MidClear, which has ambitions to become the central clearing, settlement and depository for Lebanese and other regional securities, has been returned to full ownership of the Central Bank.
21. MidClear's procedures and controls are well defined, but recent events show a need for tighter control.
22. Data loaded onto MidClear's systems from Solidere has resulted in a serious reduction in performance requiring the immediate installation of new hardware.
23. In the longer term, the French have offered their RELIT clearing, settlement and depository system.
24. Once Solidere shares are transferred to the BSE, there will be no trading on the BSM.
25. The BSM has designs on becoming a commodities, bonds and financial futures exchange.
26. The common members of the BSE and BSM appreciate the need for a common trading system to be used by both markets. However, assistance is needed in defining their individual and joint systems requirements.
27. It is not known if PRISM 96 will meet the requirements of the two markets.
28. Lebanon has sought to attract foreign investment, and there are no major obstacles to investment other than in land and a restriction on the level of foreign investment in banks and some other companies.
29. Having properly insisted that banks must establish separate subsidiaries as members of the BSE, the central bank subsequently brought brokerage firms within the bank secrecy laws, thereby making investor protection difficult to achieve.
30. The securities law does not comply with international standards and technical assistance is required to bring the law to international standards and to assist in defining the regulatory structure.

The following are a list of projects for consideration by USAID for implementation during the period 1997 to 1999:

- Technical assistance for the establishment and development of the Lebanese

Securities & Exchange Commission.

- **Technical assistance to the Beirut Stock Exchange to improve liquidity and to create a more transparent, efficient and effective capital market.**
- **Technical assistance to the Beirut Secondary Market in preparing an application to the SEC to become a recognized securities exchange.**
- **Technical assistance to the Beirut Stock Exchange and the Beirut Secondary Market to prepare a requirements specification for an automated trading system to be operated jointly by the two exchanges.**
- **Technical assistance to the Beirut Secondary Market to establish a commodities, bonds and financial futures exchange.**
- **Technical assistance to the Beirut Stock Exchange and the Beirut Secondary Market in the acquisition and installation of a new automated trading system to be operated jointly by the two markets.**
- **Technical assistance to MidClear for the acquisition and installation of a centralized clearing, settlement and depository system.**

SECTION 1

OPERATIONAL ANALYSIS

The objectives of this assessment of the Beirut Stock Exchange and related environment are as follows:

1. Prepare a diagnostic analysis of the Beirut Stock Exchange, its operations, and the related capital market and regulatory environment in order to identify the functions that most need to be strengthened and/or restructured. The primary focus will be on the recently re-opened Beirut Stock Exchange (BSE) and the Ministry of Finance.
2. Define a prioritized set of activities that may be appropriate for USAID to fund so as to strengthen the BSE and its regulatory environment.
3. Identify intermediate results and their indicators for USAID/Lebanon's Special Objective 4, "Expanded Economic Opportunities."

1.1 ASSESSMENT OF THE BSE'S OPERATIONS

Following a 13 year closure, the Beirut Stock Exchange re-commenced trading on January 22, 1996.

1.1.1 Legal Structure of the BSE

The 1983 Stock Exchange Act was amended by Decree 7667 (Implementation of the by-laws of the Beirut Stock Exchange) and published in the Official Gazette, Issue 51, 21 December 1995. An English translation of the by-laws was obtained from Mr. Gabriel Sehnaoui, Chairman of the Beirut Stock Exchange. The by-laws were later reviewed and found to be of a good standard and consistent with what should be expected of a Stock Exchange Act.

The by-laws are considered by Mr. Sehnaoui to be sufficient for the operation of the exchange at this time until a new Securities Law and changes to accounting standards can be implemented.

The by-laws set out the duties and functions of the Committee, Members and brokers of the BSE, listing requirements, trading and settlement regulations, fees and commissions, the duties and functions of the Disciplinary Board and the publication of information.

The Committee of the BSE is determined by law and includes a representative from the Ministry of Finance (the Government's Commissioner) who may over-rule a decision of the Committee in the event that he considers it would be in breach of the law.

The Committee has appointed a Disciplinary and Arbitration Committee comprising three members of the Board. This Committee has not acted since being established.

The Beirut Stock Exchange (BSE) has been established as a public entity. Each Member of the exchange has contributed \$10,000 by way of an entrance fee. Other fees are:

Annual subscription	\$2,000
Transaction fee based on value ¹ (formerly 5 per 1,000)	up to 100,000 @ 4 per 1,000 100,001 to 1ml @ 2.5 per 1,000 over 1ml @ 1 per 1,000
Initial Listing fee	\$10,000
Annual Listing fee	% of market capitalization (min \$2,000 – max \$10,000)
Other fees	Quote vendor fee not yet introduced. Reuters are currently supplying equipment free in return for no vendor fee.

A market guarantee fund was started, but this has since been suspended because of the low volume of trading on the exchange. The level was set at around \$30,000 per broker depending upon the turnover of each broker.

The BSE has introduced rules governing take-overs and mergers. No English translation was available.

Mr. Sehnaoui envisages that the BSE will trade domestic equities, corporate bonds and government and municipal authority bonds. The intention is to build up liquidity in the domestic market before tackling the listing and trading of other foreign securities particularly those of Lebanon's Arab neighbors. He also sees a strong possibility of trading commodities such as gold if the ambition to realise several free zones is achieved.

He was less positive about trading derivatives although he did recognise that there was a need to create a market index and that without a future on the index, investors would have no means, other than by block trading, of hedging the market. Two indices are currently calculated, one by Lebanon Invest and the other by Banque D'Affaires du Liban et d'Outre-Mer. The BSE has also shown an interest in calculating its own "official" index.

¹ The transaction fee is in the process of being amended, subject to Ministry of Finance approval, from a rate of 5 per 1,000. The fee is divided 64% for Brokers, 24% BSE and 12% MidClear.

He was strongly of the opinion that short-term money market instruments such as T-bills and certificates of deposit should be traded inter-bank.

Mr. Sehnaoui refers to the future privatization of the BSE, but since members have already paid an entrance fee, he is possibly thinking in terms of a member controlled board. This could be achieved by a change to the by-laws to allow a member elected board to take over the running of the affairs of the exchange. There is no intention of changing the status of the exchange to a for-profit organization nor of introducing seats.

1.1.2 Systems and Procedures, Including Automation

The trading system used at the BSE was first developed for and installed at the Beirut Secondary Market with advice from Arthur Andersen, although the software was developed in Lebanon. The system was then installed at the BSE with technical assistance from the French who also assisted in the development of the by-laws of the exchange. The BSE is looking now at the next stage of the development of the system. However, the current system has a limited life and limited functionality.

Trading is done once each day by a price fixing method. All brokers must attend the BSE to enter their orders into the system. At 11:00 a.m., the system calculates the single price at which the securities will trade on that day. With a small modification to the system, the BSE has the capability of more than one price fixing each day. This will certainly be necessary when the BSE commences trading the shares of Solidere around the end of September. The BSM currently has two price fixings of Solidere each day. The BSE's intention is to have perhaps three or four each day although it believes that the system may be capable of more. The next stage in the development of the system is for brokers to enter their orders onto a disk in their offices and to download the disks into the BSE's system. Mr. Fouad Y. Baalbaki, Trading and Information Systems Manager at the BSE, has considered the question of computer viruses and the BSE will pre-check the disks before loading them onto the system. There is still a tremendous danger in this approach, and Mr. Baalbaki is fully aware of this. Beyond this there is no migration path for the system in terms of direct remote access. The system has a design life of two years, but this could be extended. The intention is to have a fully automated electronic trading system which will provide for international linkages. The life of the system appears to be a business decision governed by the desire to go fully electronic rather than a question of system size. The system has a back-up server running in parallel; this has been fully tested. There have been no service interruptions since the start of trading. Currently only limit and at-market orders can be accepted by the system. All un-filled orders are cleared out of the system each evening.

The BSE has been offered an automated trading system by the French government. PRISM 96 is a scaled down version of the Paris Bourse Super CAC system running on Tandem computers. Mr. Baalbaki has asked for and received a systems specification for PRISM 96 which he has compared with the Super CAC system. He indicated that it provides most of the functionality of Super CAC and will provide the BSE with the capability of accepting a vastly

increased range of order types. However, he was not aware if the system would be capable of trading derivatives (which he indicated is an exchange requirement) although it can certainly trade equities and bonds. He has not carried out an analysis of PRISM 96 against the BSE's requirements. When asked about system performance, he referred to his previous analysis of PRISM 96 and said that it was capable of processing 10 orders per second over 2,000 securities. It was pointed out to him that this did not necessarily mean that the system will perform to the same specifications if all the orders are targeted at a relatively small number of securities. He took the point and will check this with the French.

The main problem of operating an automated trading system in Beirut would be communications. Existing land line communications are not sufficiently reliable or secure enough to operate such a system. In addition, with so much building work going on in Beirut there would be a very strong likelihood of localised service interruptions. The BSE has been in discussions with a French communications company to provide a radio networking capability, but detailed information on capacity, speed of communications, security of data (although there is no doubt that encryption is possible) or costs has not been provided to date.

The BSE has until the end of the year to make a decision on acceptance of the French system. PRISM 96 is currently being installed in Tunisia, and the BSE intends to look at the system in operation in Tunisia before making a decision on its acceptance for the BSE. However, it was pointed out to Mr. Baalbaki that this will not be a stress test of the system nor will he be able to judge if the system is capable of re-design to the BSE's specific requirements.

There appears to be a strong desire on the part of the BSE not to accept the French system. This is general knowledge in Beirut but unfortunately no one could or would state precisely why; however, in discussions with MidClear (the central depository and clearing operation), reference was made to the success of their project, also undertaken by the French, "because we had the advantage of on-site project management."

There is no doubt that a decision to reject the French system may have political repercussions unless the BSE can produce justifiable cause for its rejection and provide alternative funding for another system. For this reason, the BSE is keen to receive technical assistance from USAID to:

- fund a project to develop a requirements specification for the BSE's systems; and
- undertake a project to acquire/develop and implement an automated trading system at the BSE.

Without a requirements specification, the BSE will not know what it needs by way of its future systems nor will it be capable of comparing the French system with any other. However, this could be a complete waste of technical assistance if:

- the BSE decides, or is forced for political reasons, to accept PRISM 96; or
- funding is not available for the acquisition or development of an alternative system (although the existence of a requirements specification could be used by the BSE to put pressure on the French to re-develop the system, if necessary, to meet its requirements).

PRISM 96, in common with most modern automated trading systems, has a clearing and settlement module attached. Currently, clearing and settlement for BSE transactions is provided by MidClear. The exchange sees no reason why it should not do this itself although, politically, this may not be acceptable. In addition, the Beirut Secondary Market, which is currently using the identical trading system as the BSE may, due to member pressure, be persuaded to adopt a common automated trading system with the BSE (see below for details of the Beirut Secondary Market).

The BSE should discuss with the French a delay in making a decision on its acceptance of the offer to provide PRISM 96 until December 1997. Funding from the French has been allocated for this fiscal year, but it may be possible for the French to carry forward this funding into next year. The BSE should put forward the following reasons for requesting a delay:

- current low market liquidity does not justify an automated trading system;
- fixed line communications in Beirut are insufficiently secure and time is needed to assess the cost and capability of radio communications;
- the BSE needs to re-assess its method of trading in order to improve liquidity which may involve substantive changes to market procedures;
- time is needed to examine the benefits of a joint system for the BSE and BSM;
- time is needed to allow the two markets to prepare a systems requirements specification to ensure that PRISM 96 will meet their combined requirements.

1.1.3. Risk Management, Including Physical Security, Contingency and Disaster Planning, Rules and Regulations, and Risk Assessment Procedures

In practical terms, none of the market participants review systematically the principal risks associated with their own or their clients' trading activities. None of the member firms of the BSE use risk assessment models or evaluate worst case investment performance scenarios. Nor do they have monitoring and control systems to measure such risks as settlement, credit, business and default (including legal and regulatory) risks. This is not a particular issue at the current time because of two principal factors: 1) there is little or no trading activity on the BSE; 2. all brokers require cash and/or securities up front.

However, as the market develops, there will be a regulatory need not only for structured control and surveillance systems but also for the effective management of the results including contingency plans and the design of damage limitation procedures.

Regulatory market risk is that which could result in member default and thus lead to severe loss in market confidence by participants, whether or not this actually led to full systemic risk. In practice such default could occur as the result of any one of three circumstances:

- a large, generally unanticipated, move in market prices;
- improperly recorded or reported positions (principal or agency) whether as a result of

- inefficiency, fraud or mis-management; and
- bad or unsuitable investment advice.

All of these factors should be regulated and monitored by the SEC which as the market regulator, will need to define its role in monitoring market risk. A three staged approach is suggested:

- First, making use of politico/economic data to carry out anticipatory analyses of potential large market movements which might call for damage limitation steps and contingency planning.
- Second, the introduction of regulatory requirements for effective management controls and approved risk management systems, which would incorporate the need for competency testing and enhanced surveillance/monitoring systems.
- Third, a more rigorous approval structure for new product usage by investment firms which might also include further levels of personnel competency testing.

The role of monitoring market risk would thus center on reducing uncertainty, creating a more assured system of client money protection and providing a greater degree of control over potential systemic risk.

Most securities trading, other than in Solidere, is in bearer shares. Some brokers have covered themselves against handling forged documents and against physical loss. It should be a requirement of the BSE for all member firms. MidClear undertakes a depository function but only temporarily during the process of sale. Bearer shares are lodged by the seller and handed onto the buyer. It is very unlikely that buyers would be willing to have their shares held by the depository.

1.1.4 Relative Importance of Stock and Bond Markets on the BSE, and Constraints to Expansion of Both/Either

Currently, the BSE lists the shares of four companies although only the shares of Ciments Libanais are traded on anything approaching a regular basis:

<u>Company name</u>	<u>Market Capitalization as at May 31, 1996 – US\$</u>
Ciments Libanais	\$234,192,509
Ciments Blancs	28,125,000
Eternit	19,200,000
Uniceramic	29,484,000

Towards the end of September 1996, the BSE will list and begin trading in the "A" and "B" shares of Solidere. The market capitalization of which, as at May 31, was

2,002,001,320

In addition the following companies have recently issued shares and may at some stage apply for a listing on the BSE:

Casino du Liban	90,000,000
Ciments de Sibline	45,600,000
Societe des Grands Hotels (Phoenicia Hotel)	100,970,000

Casino du Liban is part state owned through Intra Investment Group (51%) and is therefore a logical company for privatization. Earlier this year the Salha family held a private placement of 31.72% of the capital of Societe des Grands Hotels. An application for listing on the BSE will follow as soon as practicable.

Apart from the above, new legislation which allows Lebanese banks to issue up to 30% of their shares without the prior approval of the Central Bank could result in a number of the banks applying for a listing on the BSE in order to raise additional capital as required by the Central Bank. An estimate of the amount of the consolidated capital of the banks that could be issued is:

240,000,000

Byblos Bank has recently issued up to 30% of its shares by way of an IPO, a condition of which is that the bank will apply for a listing for its shares on the BSE. Similar issues by other banks are expected.

However, the banks have been given the ability to buy back up to 10% of their shares, thereby allowing the banks to control the share price.

Total amount of equity capital listed or potentially listed on the BSE at the present time is	<hr/> \$2,789,572,829
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Other potential equity listings include Lebanese insurance companies which will require extensive capital injections in order to compete with the major insurance companies which are expected to return to Lebanon in the coming years. Lebanese families, owners of some of the former luxury hotels in Beirut, are also expected to follow the Salha family in seeking equity and bond finance to rebuild their hotels and other businesses. In addition, the privatization of large state utilities (electricity, telecommunications, ports, etc.) and other industry such as Middle East Airlines will result in additional listings on the BSE. Major steps are being taken to improve the tourist industry which suffered greatly because of the war and, although there were signs on an improvement during 1994/1995, suffered again as a result of the attack by Israel in April 1996. The potential for the tourist industry in Lebanon is, however, substantial and much of it will require external funding.

Family owned Lebanese companies, which account for up to 95% of all Lebanese businesses, generally tend to be averse to dilution of control, international accounting standards and disclosure of information and, therefore, seek required finance from the banks or from within the family. However, the considered opinion amongst the financial community in Beirut is that once the mold is broken others will follow. What is required is a joint government, BSE and broker education process aimed at promoting to Lebanese businesses the advantages of raising

finance through the capital market. It is also essential for the Government of Lebanon to raise accounting standards for all joint stock companies in order to create a level playing field between listed and unlisted companies.

The issue of bearer shares is, on the one hand, a considerable attraction to foreign and domestic investors who seek anonymity and can in addition hide behind the country's strict bank secrecy laws. However, trading of bearer shares tends to be on the "grey" market adding to the illiquidity of the BSE. If Company Law were to provide for Nominee Holdings, it might reduce the demand for bearer shares and still allow holders to take advantage of bank secrecy laws. Those companies whose articles restrict the percentage of foreign holders could be provided with a nationality declaration issued by the nominee company.

A number of bonds are in existence. These include:

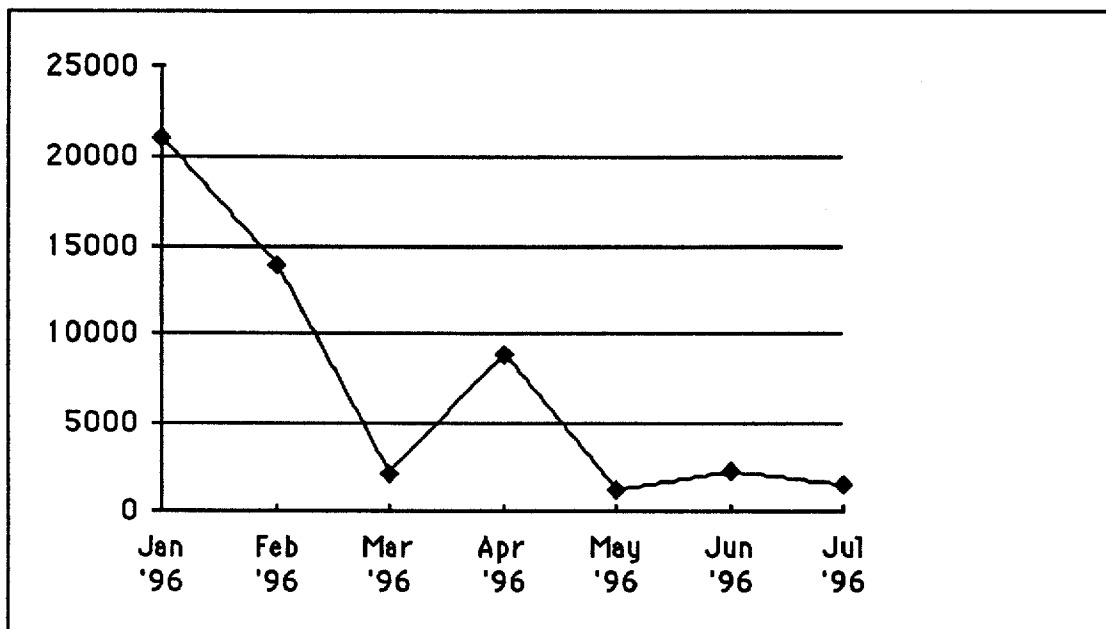
<u>Government Bonds</u>	<u>Amount issued</u>
Republic of Lebanon 10 1/8% October 14, 1997	LL 400,000,000
Republic of Lebanon 9 1/8% July 28, 2000 (First Tranche)	LL 300,000,000
Republic of Lebanon 9 1/8% July 28, 2000 (Second Tranche)	LL 100,000,000
 <u>Corporate Bonds</u>	 <u>Amount issued</u>
Ciments Libanais 9% 2003	LL 50,000,000
Ciments de Sibline 12% 2003	LL 20,000,000
Credit Libanais 9% 1999	LL 60,000,000

Ciments de Sibline is a convertible bond issue and the only one likely to be listed on the BSE.

In terms of trading, volume on the BSE has been extremely poor as shown Table 1-1:

Table 1-1

Average Monthly Volume on the BSE (expressed in US\$)



No figures were available for the BSM although daily trading volumes are currently running at around 6,000 to 7,000 shares per day, which is 65% down on figures of six months previously.

There are numerous constraints to trading:

- Lack of a sufficient number and spread of securities to trade;
- Companies that are listed are tightly held;
- Because many of the companies have issued bearer shares, trading takes place in the “grey” market off-exchange;
- Lack of international accounting standards;
- Lack of accurate and in many cases any company information;
- Interest rates are high while returns on equity investment are low;
- There is no on-exchange bond market. Bonds are generally issued off-shore;
- There are a small number of investment funds aimed at off-shore investors and high net worth Lebanese investors but none geared to the retail investor;
- Lack of public awareness;
- Poor market visibility;
- Lack of awareness at the BSE regarding what steps to take to try to improve liquidity;
- Lack of sufficiently trained and qualified people within some, but not all, brokerage firms;

All these constraints must be tackled if the BSE is to establish itself as the predominant stock exchange in the region.

1.1.5 The Investment Climate

Type of Productive Activities in which Listed Firms are Involved

Currently almost all listed companies are involved in the construction business and in particular in the reconstruction and development of central Beirut. With the exception of Solidere, there is no adequate spread of shareholdings to warrant a secondary market in these securities.

There is, however, a reasonable potential for other companies applying for listing, particularly banks and companies involved in the hotel, tourist and leisure industry.

Because of high interest rates, bonds are a more attractive investment vehicle and an increasing number of companies are seeking external finance through this medium. There are no preference shares but companies may ultimately look on this as an alternative to bonds for raising long term capital.

Several investment funds have been or are in the process of being formed. Ultimately, these may be listed on the BSE and the funds themselves may subsequently float off several of the companies in which they have invested and helped to develop.

Lack of liquidity on the BSE stems not from a lack of investors but a lack of suitable investment vehicles. Shares of existing listed companies, with the exception of Solidere, are very tightly held. To some extent, this will change slightly with the listing of banks, but the majority of shares, at least 70%, will remain under the control of a small number of people.

The Existence of State-Owned Companies, their Importance to the Lebanese Economy, and GOL Plans to Privatize Them

Potential targets for privatization include the telecommunications and power industries, the ports, the national airline and other investments held through Intra Investment Group, e.g., Casino du Liban.

Currently, there are no immediate plans to privatize state controlled industry, although the government does envisage the potential privatization of some public sector entities which will, as a result, help alleviate the dangers and potential debt service burden arising from a large build-up of debt.

Prior to introducing any large scale privatization program, it will be essential to have a more liquid capital market and to undertake an education program aimed at potential private investors and employee shareholders.

The Minister of Finance is an enthusiastic promoter of the privatization of state enterprises, though he tends to think of it in terms of contracting out key functions of the electric

utility, for example. He is not sure that the framework is in place for actual sell-off through the stock exchange. At the same time, the Lebanese Parliament's Budget and Finance Committee plans to work on a legal framework for valuing and selling of the major utilities so that a public monopoly is not replaced by a private one, and to prevent self-dealing by top government officials. This appears to be a high priority of the newly-elected Parliament once it is organized and functioning.

1.1.6 Financial Disclosure and Reporting Requirements for Listed Firms

Articles 91 to 95 of the by-laws of the BSE govern the disclosure requirements of companies listed on the exchange. These include provision for the immediate notification to the BSE of all information likely to impact on the price of the shares together with all other pertinent information necessary for the establishment of a market price making mechanism. The requirements apply to companies listed on either the Official or Junior Markets. Listed companies have a period of one year to comply with the requirements.

There is no provision in the by-laws for listed companies to adopt international accounting standards, although the Ministry of Finance is in the process of improving accounting standards in Lebanon, first for all listed companies by end 1996 and all other joint stock companies by end 1998.

The absence of reliable information on companies could be filled by the BSE, which should consider establishing a research and publications department. This has been done very successfully by the Amman Financial Market and is a revenue earner for the Jordanian exchange.

1.1.7 Registration of Firms.

An applicant for membership of the BSE must first obtain a licence from the Central Bank as a "Financial Institution." The minimum capital requirement for a financial institution is two billion Lebanese pounds (\$1.3 million). In addition, they must provide a bank guarantee of 200 million Lebanese pounds (\$130,000).

Law No. 520, Development of Financial Markets and Fiduciary Contracts, dated June 6, 1996 together with supporting regulation, "Decision number 6213 Related to Brokerage Firms" places the responsibility for the regulation of brokerage firms under the control of the Central Bank's Banking Control Commission.

The BSE has introduced an extensive questionnaire for brokers applying for membership of the exchange. The financial aspects of these questionnaires are reviewed by the western accounting firms of Coopers & Lybrand, KPMG or Arthur Andersen and reports sent to the Committee. English translations of the questionnaires were not available.

There are currently 8 brokers, which by law must be corporate entities (either subsidiaries of banks or other financial institutions), but the figure will rise to 10 by the end of September and

possibly 12 by the end of the year. The by-laws restrict the number of brokers to 32 within the first two years of the passing of the law. The committee of the BSE has discretion to increase this by 3 new brokers in each subsequent year. At the present time, there is insufficient business to support any increase in the number of members of the BSE. The theory is that new members will bring in new investors, thereby increasing the size of the cake. However, it needs to be done in conjunction with a considerable increase in the number of products. Lebanon is not suffering from a lack of potential investors but from a lack of suitable trading instruments.

Banks are not permitted to be members of the BSE in their own right but must instead form separately capitalized subsidiary companies. The fear is that banks, as members of the BSE, will over-trade and put the banks' capital at risk. The principle of separation of capacity is to be applauded as it should additionally ensure that securities trading falls outside the scope of bank secrecy laws. However, a recent decision of the Central Bank to include brokerage firms within the bank secrecy laws means that the Central Bank cannot interrogate client accounts unless the client has used borrowed funds for the transaction.

However, banks are permitted to be members of the BSM and, if the ambitions of the BSM to become a financial futures and options exchange are realised, there is a potentially far greater risk of default in this market than through securities trading. Therefore, the Central Bank should either place both markets on an equal footing or, if the decision is that banks should be members of the BSM, replace the current system of surveillance with on-line monitoring of banks' securities trading activities and implement effective position limits and risk management controls.

1.1.8 Listing of Securities

The BSE operates three markets:

An Official Market, the entry requirements for which are:

1. 25% of the capital must be in the hands of the public (however, there is no definition of "public" although this would presumably, but appears not to, exclude directors', associated companies and connected persons).
2. a minimum capital equivalent to \$3 million.
3. the number of investors holding 25% of the capital should be at least 50.
4. it should have been established for at least 3 years.

In the case of an applicant by way of a new issue, the value of the issue should be at least \$2 million.

A Junior Market, the entry requirements for which are:

1. 25% of the capital must be in the hands of the public.
2. a minimum capital equivalent to \$1 million.
3. the number of investors holding 25% of the capital should be at least 50.

In the case of an applicant by way of a new issue, the value of the issue should be at least \$1 million.

An Unlisted Securities Market (USM) exists for the trading of Lebanese Joint Stock Companies whose capital is at least \$100,000. Applications for trading on the USM can be submitted via a broker together with copies of the company registration or application for registration, a copy of the company's articles, company minutes as recorded in the commercial register for the last 3 years, and the company balance sheet and directors' report for the last fiscal year. Approval for trading is granted 3 working days following submission of the application.

The by-laws of the BSE stipulate the general provisions relating to the Official and Junior Markets which are consistent with those of a developing market.

As one of the objectives of the Junior Market is to attract venture capital companies, it would appear strange that the initial and annual listing fees for the Junior Market are the same as those of the Official Market. This point was discussed with the BSE who agreed to give consideration to a lowering of the fees for companies in the Junior Market.

As with applications for membership of the exchange, the BSE has an extensive questionnaire which it issues to companies applying for a listing. The financial aspects of these questionnaires are also reviewed by the western accounting firms of Coopers & Lybrand, KPMG or Arthur Andersen and reports sent to the Committee. All applications for listing must be supported by a broker. An English translation of the questionnaire was not available.

The BSE is currently preparing the requirements for the contents of a prospectus.

1.1.9 Training of BSE Staff.

The only training to be provided to market participants is a two week training course on the use of the existing trading system. The level of experience of brokers' staff varies greatly from firm to firm. Some firms have employed people with considerable experience in overseas markets such as US and France. Others, however, have staff with little or no experience with securities markets. There is currently no licensing or examination of individuals working in the Lebanese securities industry.

The BSE has 12 staff divided between three departments (Systems, Listing and Public Relations). Mr. Sehnoui does not currently have in place a staff development plan. However, with the introduction of a new securities law there will be a need for a staff development plan to enable the exchange to regulate the market. In addition, the staff of the exchange will need training and assistance if they are to carry out a plan to promote the exchange to listed companies and to potential investors.

It is therefore recommended that senior staff from the BSE take part in any regulatory training program to be provided for the staff of the new SEC. In addition, they would benefit from undertaking visitation and study tours to other developed and developing markets in order to broaden their knowledge about the operation and development of securities markets.

1.1.10 Trading Operations.

The BSE operates a price fixing method of trading whereby brokers enter their orders and those of their clients' directly into the exchange's systems via their own terminal located on the "floor" of the BSE. Orders are not displayed to the market. At 11:00 a.m., following the input of all orders for the day, the system calculates the price at which all listed securities will trade. The algorithm used calculates a single price at which the maximum number of shares will trade. Any balance remaining unfilled remains available for trading for one hour after the price fixing. brokers are then free to contact potential customers informing them that an unfilled order exists giving price and size. If a broker obtains a subsequent order from a client which will fill or partially fill the balance, he returns to the "floor" and enters his new order into the system. In this instance, new orders are filled in time priority. All securities are subject to a daily fluctuation limit of 5% except when they have not traded the previous day, in which case, the fluctuation limit is raised by 5% per day with a maximum of 20%.

In addition to the normal trading session, the exchange operates a "direct trading facility" between 9:00 and 9:30 a.m. whereby brokers can cross trade a minimum size of 2 million Lebanese pounds. Such trades must be within plus or minus 7% of the previous day's price fixing. A facility also exists whereby persons outside Beirut have up to six business days to declare their direct trades provided that the buyer and seller have the trade notarized on the day of trade.

There is also an extensive "grey" market in the shares of unlisted companies. For the moment this includes the shares of Solidere. There is no trade reporting of these transactions.

At the end of the day's trading, the BSE sends a list of all trades to MidClear via a modem connection from its trading system.

A list of trades is also sent to the news media.

Consultant's conclusion about the BSE's current trading system

Admittedly without knowing the cost of the development in terms of systems programming and hardware, it appears an expensive solution to a problem especially bearing in mind that the system is incapable of evolving much further than the exchange already has plans for. However, it is possible that the brokers' terminals may be used for some future automated system. The current system is merely a way of opening the market which is what it was intended for when it was originally designed by Arthur Andersen for the market in Saudi Arabia. However, due to lack of

liquidity in the market in Lebanon, it has become the system for the trading of securities on the BSE. The BSE needs to recognise that one of the elements of a successful and liquid market is the disclosure of order flow information in order to attract further orders. It needs to re-think its approach to trading in order to make the market more visible and if necessary move away from the automation process for a short period until a new automated trading system, which will provide order visibility, can be introduced. Market opening hours should be extended by one or two hours to allow investors more time to assess orders in the market. The BSE should consider some form of limit order book which would enable brokers and their clients to see orders that are available in the market and thereby encourage further order flow. The limit order book should enable further orders to be entered after the opening session and should allow the withdrawal and re-pricing of limits left untraded after the opening. At the moment, it is very much a hit or a miss whether a limit order trades and a client whose limit order does not trade has to wait 24 hours before trying again.

One of the brokers acts as a quasi (unofficial) market maker for orders of size and is prepared to make a firm price in most securities. Often the firm matches the trade with orders from its extensive client base, in which case it does not take a turn (i.e., the difference between the buying and selling prices) but charges commissions to both sides. In other cases, the firm takes the stock onto its book and trades it out at a later date, charging commission and a turn if the sale is to a client or a turn if the trade is with another member firm. Other firms generally do not take principal positions in the market although a few indicated that this may become more common in the future.

The BSE has previously discussed and rejected market makers in favour of an order driven style of market and has no desire to re-open the debate. Securities markets world-wide are divided on the advantages of a market maker or quote driven style of trading over an order driven market. It is generally agreed that where a market is liquid there is little need for market makers. However, market makers can add greatly to liquidity in illiquid markets. Other than looking at the more traditional form of market maker, the BSE would do well to learn from the experiences of the "Specialist" at the American Stock Exchange or more particularly the "Hoekman" at the Amsterdam Stock Exchange.

While recognizing that the BSE does not wish to debate the issue further, it would be a failure of duty not to recommend that the exchange should, for a trial period of six months, experiment with a formalised market maker or specialist system. This would require a change to the by-laws of the exchange and drawing up of new rules and procedures. This should be done in conjunction with the establishment of a limit order book and changes to the way in which the exchange opens the market. It will also require closer and more frequent monitoring of the firm's liquidity margin requirement. In return for certain concessions such as the ability of the specialist to view the depth of the market, the specialist should commit to making a firm price in agreed size and within agreed spreads in "normal market conditions." Priority should be afforded to trading client orders and the specialist would, in effect, take up any imbalance in the order flow. If, at end of the six month trial the change has proved successful, it should be extended. If not, the exchange should consider other forms of improving liquidity.

1.2 CLEARANCE, SETTLEMENT, AND DEPOSITORY FUNCTIONS

MidClear was incorporated in June 1994 to undertake the role of central depository and clearing house for all securities and securities transactions in Lebanon. The company was established with a share capital of LL2bn, almost entirely owned by Banque du Liban (Central Bank) apart from a small percentage owned by two Lebanese banks in order to comply with Companies Act requirements that there be three shareholders. Premises were located in the main banking district of Beirut and, with assistance from Sicovam, operations began in February 1995. During April/May 1995, the Central Bank sold up to 25% of the capital to 40 Lebanese and foreign banks (the maximum permitted by its articles).

Due to the later than expected start of the BSE and subsequent low volumes, MidClear incurred a loss during its first year of operation and sought to raise a further LL500,000 in capital. The banks objected to this and in July 1996 the Governor of the Central Bank negotiated to buy back the holdings of the banks, at nominal value, thereby returning 100% control (apart from Companies Act requirement) to the Central Bank.

MidClear currently provides a clearing and settlement operation for the BSE. All transactions are reported to MidClear by the BSE by the day following the day of trade (expressed as trade day plus one or T+1). All brokers are required to maintain a sub-account with the Central Bank for the settlement of transactions. Brokers lodge cash received from buyers into the sub-account by T+2. The cash lodgement consists of consideration plus the transaction fee (commission). Interest on cash deposited is credited to the account of the broker. The latest time for lodgement of securities from sellers is also T+2. MidClear requires one clear day to check the validity of the transfers and the securities. MidClear checks all deposits especially bearer shares against the records supplied by the companies and maintains a register of who lodged which stock. Should any forgeries be discovered, the broker who lodged the stock would be responsible for its replacement. To date, there have been no instances of forged certificates. On T+3, MidClear processes all transactions on a net settlement basis. Because MidClear is aware of all individual cash and securities lodgements, it can delay payment in the event of late delivery. The BSE is informed of all late lodgements and payments. Prior to settlement, MidClear deducts its fee (12% of the transaction fee charged to clients) together with the fee paid to the BSE (24%).

To protect against default, each broker maintains a bank guarantee with the BSE against its securities transactions. All unsettled transactions are "marked-to-market" each day.

MidClear also acts as the depository for securities the majority of which are in bearer form. The high proportion of bearer securities is a throw-back to the former days of the stock exchange in Beirut (no doubt French influenced): most investors not only take full advantage of the bank secrecy laws but prefer the secrecy afforded by holding bearer securities. MidClear would favour all holdings in registered form and attempts are being made to move slowly towards dematerialization, first by immobilization. However, investors prefer to have a piece of paper that they can look at. Assistance has been provided by the French in drafting a law on dematerialization.

MidClear's procedures and controls are well defined and security of data and information appears to be reasonably well controlled. The systems, which are less than two years old, run on Tandem, fault tolerant, K100 mid range computers using a client server. The system is configured for 2gb of hard-drive and 16mb of memory. UPS is automatic and runs from three generators. There is one hour of battery in the event the generators fail to kick in. During a recent failure of the public electricity supply, the generators started but failed to supply power to the computers which were closed down within 45 minutes. The fault lay in the connections from the generators and has now been rectified. One machine is dedicated to live running and the second provides on-line back-up and is used as a development machine. During recent work on development and testing, the back-up machine was incorrectly closed down and caused a general failure of the system. Tandem subsequently recommended that development and testing does not take place during live running. The system is closed down each evening and back-ups are stored in the computer centre and separately at the Central Bank. There is no disaster recovery site. MidClear is in the process of moving its computer centre into the Central Bank. The move is expected to take place 21/22 September.

MidClear is seeking technical assistance in defining further enhancements to the current system particularly in order to cater for the expected expansion of the market and possible linkages between the BSE and the Cairo and Kuwait Stock Exchanges on dual listing of securities. In addition, MidClear is seeking a link with Euroclear which has just announced acceptance of the Lebanese currency. The French have offered their RELIT system but Mr. Abou Asli, Assistant General Manager of MidClear, is unsure if it will meet their requirements. MidClear's current hardware is Tandem and RELIT's software (RPG3) is incompatible with the current system. Both PRISM 96 and RELIT have clearing and settlement functionality built into them and therefore, if the BSE accepts PRISM 96, it could run its own clearing and settlement operation. However, for strategic reasons, this may not be acceptable to the Government of Lebanon. It should also be noted that the British Bank of Middle East is considering establishing a depository of its own.

With effect from end September, MidClear will handle the clearing and settlement of Solidere. All of Solidere's files have been down-loaded to MidClear and from the date of transfer to end October Solidere and MidClear will operate parallel systems. Subsequent to this period of acceptance testing, MidClear will assume responsibility for clearing and settlement. Following the down-load of an extensive file of data from Solidere which took 24 hours to load, MidClear's systems experienced a loss of performance. Diagnostics run by Tandem pointed to a need for increased storage and processor memory. Tandem have recommended the replacement of the K100 machines with the Tandem ELS system running on K1000 machines. These have 8gb of hard-drive and 64mb of memory. The added advantage of making this change is that the platform will also support Unix applications thereby resolving a potential problem if the decision is taken to accept the French RELIT system.

The long term objective of MidClear is to become the central depository and clearing house for financial instruments in Lebanon and the Middle East. It also proposes to become the Central Registry for companies in Lebanon. Solidere was created by an Act of Parliament which strictly controls the method of transfer of shares, the issue and signing of certificates and provides that the company will maintain its own register of members. Changes to the Act are required for MidClear

to take over the role of company registrar.

MidClear will be a recognized body under the new Securities Law and although owned by the Central Bank, will be regulated by the Securities Commission.

1.3 THE BEIRUT SECONDARY MARKET

In undertaking this assignment, the consultant has also carried out an assessment of the Beirut Secondary Market (BSM). Until recently, the BSE and the BSM have displayed open hostility towards each other. There appears now to be an acknowledgement of the need for an equity market (to be provided by the BSE) and a financial market (the BSM) and a coming together in terms of products to be traded on each exchange although both exchanges regard themselves as the logical place for trading government and corporate bonds. The BSE is regarded as the primary place for raising equity finance and for the secondary trading of equity securities. This could encompass the trading of equity based derivatives in the longer term. The BSM on the other hand has a bank dominated membership which should logically trade debt, currency and interest rate products. This is certainly the view of Dr. Nasser Saidi, First Vice Governor of the Bank du Liban (the Central Bank of Lebanon) an acknowledged expert on securities markets in Lebanon and the author of a number of publications on the subject. The question of where long-term government bonds (the secondary trading of T-bills is acknowledged to be the prerogative of the BSM) and more particularly corporate bonds are to be listed and traded is really one for the Lebanese to resolve. Certainly, the market is too small to withstand internal competition. However, as most companies with bond issues would already have their equity shares listed on the BSE, it would avoid over-complication if they only had one body to report to. This is particularly important when there is a convertible bond where the price of the bond is influenced as much, if not more, by the price of the equity into which it is convertible.

The Beirut Secondary Market was established by Agreement signed on June 21, 1994 between the Central Bank and nine Lebanese banks and financial institutions (the founding members). Membership is open to a maximum of 34 banks and other financial institutions. That maximum has now been achieved and includes both Lebanese and foreign banks.

The ruling body is the Beirut Secondary Market Committee which has established rules governing membership, listing, trading, clearing and settlement and member compliance. Trading, clearing and settlement takes place at the premises of Société Financière Du Liban S.A.L. which is also responsible for implementation of the rules and decisions of the committee and for companies compliance with listing requirements. In effect, they run the market. There is no market guarantee.

Brokers (members) pay an annual membership fee of \$15,000 and 20% of their commission. The maximum commission level is:

- 5 per thousand up to \$100,000
- 3 per thousand between \$100,001 and \$1,000,000
- 1 per thousand above \$1,000,001

The minimum commission level is \$10.

Listed companies pay an annual membership fee of:

2 per hundred thousand of the nominal paid up capital of the company with a minimum fee of \$15,000

The only security trading on the BSM is Solidere which is due to transfer to the BSE at the end of September.

The BSM was established, in the absence of the BSE, to meet a particular need, i.e., to provide a central market place for the trading of the "A" and "B" shares of Solidere. Now that Solidere is transferring to the BSE and bearing in mind that the BSE also has a Junior Market and USM capability, there would appear to be no need for the BSM. Dr. Saidi would like to see the BSE responsible for equities and equity based derivatives whilst the BSM would be a debt and bank instrument market trading bonds (both government and corporate), T-Bills, interest rate and currency products. The BSM's ambition is to be a financial market trading primarily currency and interest rate products including derivatives. Their first product is likely to be a currency put option and discussions have been held with Arthur Andersen on the development of such a product. However, as the Lebanese pound is strictly controlled by the Central Bank, there is no volatility and it would be necessary for the Central Bank to allow the currency to float within a wider range than it currently allows. The BSM believes that the Central Bank could play the role of writer of these put options and collect the premium from the buyers. The danger faced by the Central Bank is that premium income may be insufficient to cover potential losses on trading. However, if properly managed, there may be no greater risk than the Central Bank's current exposure in supporting the level of the Lebanese pound. Working in favor of the Central Bank and against the market would be its ability to manipulate the market by allowing the currency to fall during the life of the option and then, by buying Lebanese pounds and selling US dollars, raise the level to at or above the strike price at expiry.

The trading system is identical to the system used at the BSE. It was first developed for the BSM and re-developed for the BSE. Mr. Saidi would not be opposed to a common system being developed for the BSE and the BSM. Certainly, the common members of the two markets would welcome a single automated trading system which could produce substantial savings in terms of hardware and communications costs.

It will be necessary for the BSM to make an application to the new SEC to become a

recognized investment exchange. Prior to making such an application, the BSM should consider its future role. Ideally, it should be a commodities, bonds and financial futures exchange and change its name to the Beirut Financial Market. However, corporate bonds should be listed and traded at the BSE. Although the management of the BSM is currently looking at the potential for a domestic financial market, there are no other markets of this nature in the Arab world although futures and options exist on the Israeli Stock Exchange. Futures and options are regarded under Islamic Law as speculative investments and are therefore not permitted. The BSM should therefore consider international products, e.g., a Saudi Riyal/US\$ contract or an Egyptian interest rate product. Market research is obviously needed but other than an inter-bank market no one is trading these type of products on-exchange.

In the present climate and given the fact that the Central Bank will not allow banks to be members of the BSE, it would not be possible for the two exchanges to merge. However, Lebanon is too small to support two markets, the membership of which is, or will be, largely common. The costs to the member firms in terms of membership, trading, clearing and settlement fees are largely doubled as are communications costs. Members have to maintain two systems and two types of procedures for clearing and settlement. The cost of regulation is also increased by having two markets. It is therefore recommended that the BSE and BSM should:

1. Consider and, if appropriate, adopt a single automated trading system;
2. Create a jointly owned company for the operation and maintenance of the system;
3. Use MidClear as a common clearing and settlement agent;
4. Appoint a working party to consider the question of amalgamation.

SECTION 2

ASSESSMENT OF THE LEGAL AND REGULATORY ENVIRONMENT

2.1 PROPERTY RIGHTS

Foreigners or foreign companies are permitted to acquire property subject to ratification by a presidential decree. Foreign companies, in this respect, are defined in two ways. First, the majority of shares in general partnerships and limited liability companies must belong to Lebanese citizens or companies and cannot be transferred to third party foreign nationals. Second, a minimum of one-third of the company's shares must be held by Lebanese citizens whose company statutes prevent those shares being transferred to a non-Lebanese third party. Foreign companies may acquire property under 10,000 square meters for their own purposes as long as the above requirements are met.

The law on foreign ownership of land, although not considered a problem by the Lebanese in terms of the securities market, has not been tested by a foreign take-over situation and indeed did cause problems in the case of Solidere where the nationality requirement on shareholders precluded their participation in real estate development. In addition, it would undoubtedly prevent foreign ownership of agricultural land.

There are no problems associated with the rights of shareholders in the event of bankruptcy.

2.2 CIVIL LAW COURTS – RECOURSE FOR INVESTORS

The new draft Securities Law provides for the establishment of a special court to deal with investor complaints. Currently, recourse can be sought through the courts, but the process is time-consuming and costly. The establishment of this "special court" will greatly speed up the process.

2.3 TAX TREATMENT OF LEBANESE AND FOREIGN INVESTORS

Income tax is 10% for foreign and Lebanese companies and ranges from 3% to 10% for individuals. Any dividends distributed to shareholders are subject to a 5% distribution tax payable by the company. Double taxation agreements exist with a large and growing number of countries.

There is no capital gains tax on share transactions. Capital gains tax of 5% is, however, payable on property and on the trading of T-bills and bonds. Brokerage firms and other "dealers in securities" are exempt from capital gains tax on their trading activities as principals.

2.4 FOREIGN INVESTORS' STATUS AND ACCESS TO MARKETS

Lebanon has set out to encourage foreign investment although there are restrictions on ownership of property and a Central Bank regulation prohibiting the transfer of more than one third of the shares of commercial banks to other than Lebanese persons. Apart from this and from some companies which, by their Articles, restrict the percentage of foreign ownership, there is complete freedom of investment including repatriation of profits and dividends.

The Central Bank has issued regulations governing the establishment and operation of a foreign financial institution's branch in Lebanon which essentially allows it to carry out all kinds of credit operations (discount, commercial or documentary credit, overdraft, credit against physical or personal guarantees, etc.) using private funds or funds acquired from banks and from financial institutions. A foreign financial institution's branch can also carry out the following operations on a secondary basis:

- The purchase and sale of securities or money market instruments for its account or the account of its clients.
- Portfolio management.
- Financial research and consultancy.
- Assistance in the issue of securities and their marketing and/or underwriting.
- Real estate management.

The Central Bank has also issued regulations requiring that at least one third of the nominal shares of brokerage firms should be owned by Lebanese nationals in keeping with the rules and regulations concerning the regulation of transfer of shares of Lebanese banks. Ownership of more than 10% by one individual requires Central Bank approval.

2.5 APPROPRIATE BALANCE BETWEEN REGULATION AND MARKET DEVELOPMENT

The by-laws governing the establishment and operation of the BSE provide adequate provision, at this stage in the development of the market, for the protection of investors trading on-exchange. However, at this time, neither the BSE nor the Central Bank's Banking Control Commission are exercising regulatory supervision over the activities of members of the BSE. In addition, transactions taking place off-exchange go totally unregulated. No one can put a figure on the amount of off-exchange trading that takes place, but opinion is that it is certainly greater than that traded through the BSE, perhaps by a multiple of ten.

Listing rules do exist and the BSE has allowed one year for listed companies to comply with them.

In many ways, regulation compares favorably with other emerging or developing markets. The nature and scope of regulation, including current and expected future roles of self-regulation and external oversight by government, are summarized below.

2.5.1 Money Laundering

The Banking Association has discussed regulations regarding money laundering and as a result, all forex brokers are required to report physical transactions of over \$10,000. Although the banks in Lebanon are bound by strict secrecy laws, it is not regarded as a major problem because, due the relatively small size of the financial community in Beirut, everyone knows each other and they are able to turn away “hot” money from, for example, Russia. This money tends to find its way into Cyprus.

2.5.2 Insider Trading

The BSE has looked at the question of insider trading, particularly in view of the bank secrecy laws, and has made the company responsible if there is something wrong. Obviously, this is of concern particularly in take-over situations where it may not be in the personal interests of the company directors to take action if they were the perpetrators – this point was made known to Mr. Sehnaoui. Although the new Securities Law will contain provisions on insider trading, it should be noted by the Lebanese that Swiss bank secrecy laws do not affect the prosecution of insider trading.

2.6 CAPITAL MARKET LEGAL PROVISIONS – PROPOSED LEGISLATION FOR ACTION BY PARLIAMENT, COMPARED TO PAST/EXISTING LAWS

2.6.1 Current Regulation

Law No. 520 “Development of Financial Markets and Fiduciary Contracts” dated June 6, 1996 defines financial institutions as those “whose main objective is the management of moveable assets, placements, investments, and financial intermediation, the management of syndicated loans, mutual funds, the issuance and marketing of different kinds of bonds, repurchase and sale of financial instruments, various types of credit granting and lending on a professional ground, and other related operations.” All institutions falling within this definition must have a licence, issued by the Central Bank in accordance with articles 128 and 131 of the Code of Money and Credit.

Article 8 of Decision number 6213, “Related to Brokerage Firms,” issued on June 28, 1996 states that “the Bank of Lebanon has the prerogative to issue recommendations and instructions and to use the means that ensure the proper functioning of brokerage firms. Brokerage firms must bind to recommendations and instructions issued by the Bank of Lebanon according to provision 1 of law 520 dated 6/6/96 and to provisions of this decision.” In effect, this gives the Central Bank full regulatory control over the operations of brokerage firms and the power to issue regulations determining their operations.

The Banking Control Commission, which is responsible for the registration and surveillance of brokerage firms under Law 520, does not intend, nor does it appear to have the powers, to advise the new SEC or the BSE of any information in its possession. To date, the

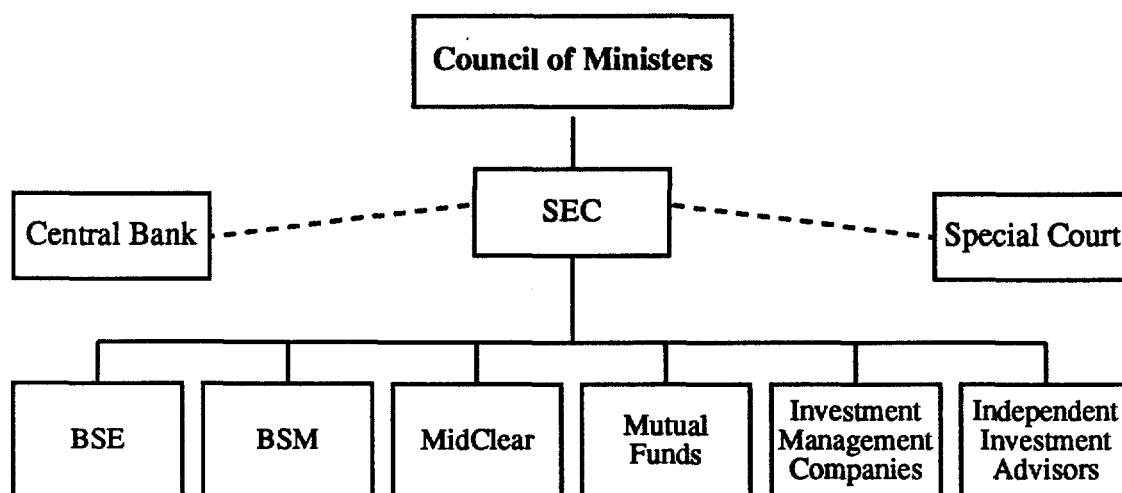
Banking Control Commission has not carried out any investigation or visited any brokerage firms. Two reasons were cited for this: the law has only recently been passed, and the staff of the Banking Control Commission do not have the experience or the training.

Article 14 of Decision number 6213 states that “the Banking Control Commission controls brokerage firms and branches of foreign brokerage firms operating in Lebanon according to rules and regulations complied with by banks or to those determined by the Bank of Lebanon.” As a result, brokerage firms fall within the 1956 Bank Secrecy Laws which prohibit the Banking Control Commission from seeing, let alone interrogating, any client account, client ledger or contract note where the client has paid for the share transaction with his own funds. Only in the case where a client has purchased securities using funds borrowed from the brokerage firm may the Banking Control Commission view the relevant information. As a result, the Banking Control Commission cannot ensure that the price reported the client is the same as that paid by the brokerage firm. This has major implications for investor protection because, as there can be no interrogation of certain client accounts, it cannot be ascertained whether or not the client paid the same price that the broker bought the shares in the market. It was suggested that the inclusion of brokerage firms within the bank secrecy laws was done because foreign investors want to invest in Lebanon because of its bank secrecy laws. However, investors generally invest for reasons of profit and if they are motivated by the country’s bank secrecy laws could always do so via a bank which can make the purchase, through a brokerage firm, in its own name “account client X,” thereby protecting the identity of the client. There is no doubt that some investors, most particularly from the Arab world, do take full advantage of Lebanon’s bank secrecy laws and this has to be encouraged and further developed by offering new domestic products and the opportunity of trading international products in Lebanon or through Lebanese intermediaries. However, care has to be taken not to do so at the expense of investor protection.

2.6.2 New Securities Law

It is hoped that a Securities Law, which is in its final stages of drafting and includes remarks from the Ministry of Justice, will be submitted to Parliament in October and become effective by the end of the year. The law follows the French style in keeping with all other Lebanese laws. It is enabling legislation (in other words a framework law) which establishes a Securities Exchange Commission (SEC) responsible for the regulation of financial markets in Lebanon. The law will enable the SEC to regulate the Beirut Stock Exchange and any other exchange established in Lebanon, MidClear (as the central depository), mutual funds, investment management companies, and other financial institutions undertaking “securities business” on the Lebanese financial market. The law, which it was stated, includes provision for investor protection and insider trading, also establishes a Special Court for the speedy and efficient handling of investor complaints.

The Securities Law establishes the SEC as an independent body established by the Council of Ministers. The SEC will be comprised of a President, Vice President, the Vice Governor of the Central Bank, the Permanent Secretary to the Ministry of Finance and two experts, one of whom will be a financial expert and the other a legal expert. Although appointed by the Council of Ministers, the SEC does not report to it nor is it accountable to it.



In order to define the terms of reference for a project to support the establishment, training and development of an industry regulatory body, it was necessary to have a clear definition of the scope of regulation and the roles to be played by different bodies. Because the most recent draft is in Arabic, it was impossible to undertake a detailed analysis of the draft law. However, discussions were held with Dr. Nadim Munla, representing the BSE and the Ministry of Finance, and Mr. Toufic Chambour from the Central Bank. The consultant's understanding of the contents of and requirements for the new securities law is as follows:

There are three basic pre-requisites:

1. that the law should provide investor protection;
2. that the law should conform to international standards; and
3. that the law should be compatible with existing legislation.

In-so-far as point 2 is concerned, the Ministry of Finance would prefer to see a "moderate" law in keeping with the stage of development of the financial markets in Lebanon. However, care has to be taken that in so doing the law also complies with point 1, that of ensuring investor protection. Under Lebanese law, unless something is expressly forbidden, by virtue of its omission it becomes permissible. In addition, in the fast changing world of financial markets, new products and services emerge that may not be fully covered by legislation. Although the SEC has the power to issue rules or regulations, it cannot go beyond the scope of legislation unless it goes back to Parliament and seeks a change to legislation, which can be a time consuming process. In addition, Lebanon is seeking to attract inward investment on a very substantial scale and without a strong regulatory environment, international investors will be particularly wary of investing in Lebanon.

Therefore, the law should be sufficiently strong to ensure the protection of domestic and international investors without hindering the development of the financial markets in Lebanon. A properly worded securities law, compatible with international standards, will meet these

requirements. It is in the area of regulation where one can have a degree of flexibility as to what is appropriate for market development – not the law.

The law should cover four basic areas:

1. What is regulated

Greater thought has to be given to the instruments that the law is designed to cover. In this respect, the law must clearly differentiate between securities and money market instruments although care has to be taken in properly defining derivative products which, although they may appear to fall within the scope of money markets, are in fact securities.

2. Who is regulated

The draft law refers to financial markets and does not cover individuals. It is essential that the SEC has regulatory power over individuals which implies the licensing of those individuals. In-so-far as insider trading is concerned, the law should seek powers to make insider trading a criminal offence thereby ensuring that company directors and other connected persons fall within the scope of legislation.

3. Who regulates

Law No. 520 and Decision number 6213 clearly places responsibility for the regulation of Brokerage Firms under the domain of the Central Bank. This could encroach on what should be the responsibility of the SEC and could impact on the duty of the BSE to regulate its members in compliance with its licence as a recognized stock exchange. However, in keeping with requirement 3 that the law should be compatible with existing legislation, a workable solution should be found whereby the Banking Control Commission will continue to provide at minimum financial regulation over Brokerage Firms, leaving the SEC and the BSE to undertake their respective functions of securities industry regulator and market regulator.

4. What powers does the regulator have

The SEC should have regulatory responsibility for securities business and the full range of disciplinary powers at its disposal over all licensed legal entities and natural persons.

The law does not include a definition of securities, controls over advertising, or over-the-counter (OTC) trading which is substantially greater in volume than on-exchange trading. It is important to ensure that OTC business is brought within the territory of the SEC for the protection of stock exchange business and to ensure that all participants operate on a level playing field. Nor does the law require licensing of individuals – either those employed by financial institutions or independent intermediaries acting as investment advisors who, through their personal networks, are facilitating trading. It is essential that the SEC has regulatory control over individuals and can discipline individuals as well as corporate bodies.

Apart from the deficiencies in the current draft of the law, there is a very real danger that the market either becomes over regulated or that regulation will be ineffective, for example in the area of OTC trading. In keeping with their laws, the Lebanese have followed the French style of regulation. However, the Banking Control Commission cannot properly regulate brokerage firms and other financial institutions because of Lebanese Bank Secrecy Laws and therefore cannot ensure investor protection; nor is it charged with so doing.

Obviously, care has to be taken not to create yet another body responsible for regulating securities firms in Lebanon. For this reason, the Central Bank should only exercise its powers under "Decision number 6213" and in particular only exercise its prerogative under Article 8 thereof in respect of the financial regulation of Brokerage Firms. This would allow the SEC to take regulatory responsibility for securities issuance and trading. Whether or not the SEC directly employs staff to carry out the functions of regulation and enforcement or whether it devolves responsibility to another agency or agencies is a matter of control and economics.

Clearly, the SEC will require some staff who will undertake the tasks of drafting regulations and of assisting the members of the SEC in implementing regulatory policy. In addition, there are those organizations and individuals who will require to be regulated directly by the SEC such as mutual funds, investment management companies, and others who are not members of a particular market but are undertaking investment business in Lebanon.

Any large scale USAID technical assistance in establishing and developing an SEC in Lebanon could not commence before the end of 1996 and on current prediction the new securities law may be some way towards implementation by that time. It is therefore recommended that USAID undertakes, in advance, to carry out a short term project to review and comment on the current draft of the new securities law and to provide assistance in determining a new regulatory structure for the Lebanese financial markets. Such a preliminary project would thereby eliminate many of the difficulties that would be encountered by a consultant appointed to undertake a major USAID project to establish and develop the SEC. It is vitally important that the consultant is presented with a regulatory structure and a modern securities law within which they can work instead of initially having to review and propose changes to existing securities legislation and regulatory framework. Apart from the time it will take to amend existing legislation, members of Parliament will not take kindly to re-debating a law so recently passed.

2.7 Other Key Factors or Changes that are Likely to Enhance or Inhibit Development of the Market with Appropriate Regulation to Encourage and Safeguard Investors.

Accounting Standards

The Ministry of Finance has been working on improving accounting standards in Lebanon and the introduction of international accounting standards is to be phased in as follows:

By end 1996 - All companies listed on the BSE's first and junior markets must comply with the new standards;

By end 1997 - All banks, insurance companies and companies of more than LL10bn capital;
By end 1998 - All shareholder companies with a capital of between LL1bn and LL10bn;
By and 1999 – All companies.

The introduction of international accounting standards for all shareholder companies by end 1998 will remove a barrier to listing and create a level playing between listed and unlisted securities.

SECTION 3

RECOMMENDED ACTIVITIES

This section provides an estimate of the assistance needed and desired by BSE, GOL, and the securities industry in Beirut.

3.1 AREAS OF NEED OR INTEREST

1996

Technical assistance to the Central Bank and the Ministry of Finance to:

1. review and comment upon the current draft of the Securities Law; and
2. discuss with the Central Bank, the Ministry of Finance and other interested parties and advise on the most appropriate structure and method of regulating the financial markets in Lebanon.

1997 – 1999

1. Technical assistance for the establishment and development of the Lebanese Securities & Exchange Commission
2. Technical assistance to the Beirut Stock Exchange to improve liquidity and to create a more transparent, efficient and effective capital market.
3. Technical assistance to the Beirut Secondary Market in preparing an application to the SEC to become a recognized securities exchange.
4. Technical assistance to the Beirut Stock Exchange and the Beirut Secondary Market to prepare a requirements specification for an automated trading system to be operated jointly by the two exchanges.
5. Technical assistance to the Beirut Secondary Market to establish a commodities, bonds and financial futures exchange.
6. Technical assistance to the Beirut Stock Exchange and the Beirut Secondary Market in the acquisition and installation of a new automated trading system to be operated jointly by the two markets.
7. Technical assistance to MidClear for the acquisition and installation of a centralized clearing, settlement and depository system.

Other recommendations, many of which can be implemented by the authorities in Lebanon without technical assistance, include:

- Company Law should provide for “Nominee Holdings.” This will reduce the demand for bearer shares. Nominee companies can provide a declaration of nationality for those companies who require it.
- Further issues of bearer shares and bearer bonds should be discouraged.
- Company Law should be amended to provide for dematerialization and companies should be encouraged to move towards dematerialization.
- The law creating Solidere should be amended to provide for dematerialization, and MidClear should undertake the function of company registrar.
- The Beirut Stock Exchange should re-assess its method of trading and should, in particular, consider the establishment of a “limit order book,” reconsider the question of priority for “at-market” orders, and conduct a study of ways in which liquidity may be improved including a formalised market making system with rules on minimum size and firmness of price.
- The Beirut Stock Exchange should request from the French a one year delay in the time by which the exchange has to make a decision on PRISM 96. The reasons are: current low market liquidity does not justify an automated trading system; fixed line communications in Beirut are insufficiently secure and time is needed to assess the cost and capability of radio communications; the BSE needs to re-assess its method of trading in order to improve liquidity which may involve substantive changes to market procedures; time is needed to examine the benefits of a joint system for the BSE and BSM; and time is needed to allow the two markets to prepare a systems requirements specification to ensure that PRISM 96 will meet their combined requirements.
- The Beirut Secondary Market should become a commodities, bonds and financial futures exchange. Corporate bonds should, however, be traded at the BSE.
- The BSE and the BSM should establish a jointly owned company for the maintenance and operation of a common trading system.
- All clearing and settlement of the two markets should be via MidClear.
- The BSE and the BSM should establish a joint working party aimed at bringing about the amalgamation of the two markets.

3.2 ALTERNATIVE SOURCES OF HELP

1. The French have already provided considerable assistance in establishing the BSM, the BSE and MidClear. The further technical assistance offered is:

- An automated trading system (PRISM 96) for the BSE;
- A clearing, settlement and depository system (RELIT) for MidClear.

In addition, the French have been/are providing some assistance in reviewing drafts of the securities law. It is understood that this assistance is being provided by the Commission des Opérations de Bourse (COB) which has been sent copies of the most recent drafts for review and comment.

2. The World Bank has provided \$196,000 for assistance in establishing a capital markets supervisory authority and developing the skills of the Banking Control Commission in regulating market participants. The project, which is under the control of Dr. Nadim Munla, is concerned largely with the training of regulatory officials and includes provision for overseas study tours.

3. EC funding may be available for joint venture projects through the European Community Investment Partners (ECIP) program. In addition, there are a number of joint venture programs available to support to government and public agencies.

3.3 APPROPRIATE USAID-SUPPORTED ASSISTANCE AND TRAINING

3.3.1 1996 – Intermediate Project

This project would provide technical assistance to the Central Bank and the Ministry of Finance to review and comment upon the current draft of the Securities Law and to advise on the most appropriate structure and method of regulating the financial markets in Lebanon.

Objectives/expected results

The objectives of this project are to:

1. resolve the perceived deficiencies in the current draft of the Securities Law;
2. provide Lebanon with a modern Securities Law to international standards;
3. establish a regulatory structure appropriate for Lebanon's financial markets;
4. resolve any difficulties in the legal and regulatory framework prior to USAID undertaking a major project to establish and develop the SEC.

Length of training or assistance

The technical assistance should be completed within six to seven weeks of start date.

Targeted groups or organizations

The Central Bank, Ministry of Finance and other interested parties including local legal experts and senior market practitioners (drawn from the body that has been preparing the current draft of the Securities Law).

Sequence

The project should commence immediately with the objective of completion by the end of 1996.

Expertise needed for this assistance or training, and suggested sources

This activity requires a securities lawyer (conversant with French law) and a securities market regulatory expert. They would undertake a review of an English translation of the current draft of the securities law and identify those areas in which the draft law fails to comply with international standards.

They would then work (in Lebanon) with a small team of local legal experts and senior market practitioners (drawn from the body that has been preparing the current draft) to discuss their comments on the draft law and to arrive at a consensus of opinion on what areas should be covered in the law and also what should be left to subsidiary regulation. The objective will be to structure a law that:

- provides investor protection;
- conforms to international standards; and
- is compatible with existing legislation.

The consultants would also advise and agree, with the local team, on the most appropriate method of regulating the market in Lebanon bearing in mind the need for investor protection, local conditions, the stage of development of the market, and the high cost of regulation. The output would be an agreed regulatory structure defining the roles to be played by the SEC, the Central Bank, the BSE and any other bodies.

A revised draft of the securities law would be prepared by the securities lawyer (at home base) following which the securities lawyer would travel to Beirut for discussions and agreement, with the local team, on the revised draft.

The estimate for completion of the work is:

<u>Task</u>	<u>Securities Lawyer (Person days)</u>	<u>Regulatory Expert (Person days)</u>
Pre-project briefing	2	2
Review draft securities law (2 days of review, 1 day to document)	3	3
Discuss and agree content of law	6	6
Discuss and agree regulatory structure	3	3
Re-draft securities law	12	
Discuss and agree re-draft	6	
Total person days	32	14

Estimated cost: \$60,000 to \$70,000

Where it should be best done (in Lebanon or US)

The majority of the work, with the exception of two weeks for drafting, should be done in Lebanon.

Notable differences in perceptions of what is needed or possible

The Lebanese have already spent considerable time and effort on drafting a securities law and have no desire to delay the process further. In addition, although they recognise that Lebanon needs a securities law of international standards, it is the perception of some that this should be achieved over time, as the market develops. This would necessitate frequent amendment of the securities law whereas the consultant suggests that the law should, from the outset, conform to international standards, and it is the rules, or regulations, that should be progressively introduced in accordance with market development.

3.3.2 1997-99 – Project 1

Technical assistance for the establishment and development of the Lebanese Securities & Exchange Commission.

Objectives/expected results

The objectives are to:

- 1) complete the design and implement the organization, structure and functions of the SEC as determined by the project set out above;
- 2) establish the administrative procedures of the SEC;

- 3) train executive, professional and support staff in financial, regulatory and capital market skills;
- 4) provide legal and regulatory assistance to review existing legislation, propose and assist in implementing a plan to harmonise and improve the legislative framework for capital markets;
- 5) provide legal and regulatory assistance to establish the SEC and to draft and adopt substantive regulation of the capital markets to be issued by the SEC;
- 6) assist the Beirut Stock Exchange and the Beirut Secondary Market in re-drafting their rules to comply with new legislation and regulation; and
- 7) establish a securities industry examination system.

Length of training or assistance

The project should be over a two year duration commencing around January 1997 and should include a resident regulatory expert to provide on-going assistance to the SEC during the life of the project.

Cost estimate based on other similar projects in which the consultant has been involved – \$1,500,000 to \$2,000,000 plus surveillance and examination systems costs estimated at \$250,000.

Targeted groups or organizations

The SEC, Central Bank, Ministry of Finance, BSE and BSM should be targeted. A Project Steering Committee should be formed drawn from representatives of the above and from industry participants.

Sequence

The project should commence following the passing, by Parliament, of the Securities Law and once the SEC has been formally established.

The project should:

- 1) identify deficiencies in current legislation and propose amendments and/or additions to existing legislation;
- 2) complete the design of and implement the organization, structure and functions of the SEC;
- 3) draft substantive regulation of the capital markets to be issued by the SEC;
- 4) prepare codes of ethics for market participants;
- 5) identify the systems requirements necessary for the SEC to undertake its regulatory function;

- 6) assist the Beirut Stock Exchange and the Beirut Secondary Market in re-drafting their rules to comply with new legislation and regulation;
- 7) establish the administrative procedures of the SEC including the preparation of procedure manuals and educational material;
- 8) train executive, professional and support staff in financial, regulatory and capital market skills. This would include overseas study tours to the United States and other developed and emerging markets; and
- 9) establish a securities industry training course and examination system.

Expertise needed for this assistance or training, and suggested sources

A consultancy firm experienced in the development of regulatory structures in emerging markets could provide such expertise. The consultant should have experience of working in Arab countries and at least one member of the team should be fluent in Arabic. Particular knowledge of French law would also be advantageous. At least one member of the team should have experience of actually running a securities regulatory body.

Technical Assistance Site (in Lebanon or US)

The majority of the work should be done in Lebanon.

The securities industry training course and examination could be operated by the American University of Beirut.

Notable differences in perceptions of what is needed or possible

None.

3.3.3 1997-99 – Project 2

Technical assistance to the Beirut Stock Exchange.

Objectives/expected results

The objectives are to:

- 1) increase market liquidity by reviewing and, if necessary, changing the trading operations and style of trading;
- 2) attract new companies to listing on the exchange;
- 3) increase order flow and improve market transparency;

- 4) promote the exchange to domestic and foreign investors (this would include an extensive domestic educational program aimed at improving public awareness of financial markets);
- 5) establish a research and publications department; and
- 6) attract new members to the exchange;

Length of training or assistance

The project should be over a two year duration commencing early 1997.

Estimate of technical assistance required – 12 staff months.

Targeted groups or organizations

The Beirut Stock Exchange and its members.

Sequence

The project should commence with a review of the analysis already carried out. Plans should be prepared and discussed with the BSE for the achievement of the objectives and agreement reached on the implementation of these plans. The consultant should then assist in the implementation of the plans and monitor their effectiveness.

Expertise needed for this assistance or training, and suggested sources

A consultancy firm experienced in the development of stock exchanges in emerging markets is required. The consultant should have experience of working in Arab countries. At least one member of the team should have prior experience of actually running a stock exchange.

Technical Assistance Site (in Lebanon or US)

The work should be done in Lebanon.

Notable differences in perceptions of what is needed or possible

Lebanon needs a strong capital market in order to attract inward investment and to assist in any future privatization program. However, there may be resistance from the BSE to trying out new methods of trading, e.g., there is opposition to anything other than an order-driven market.

3.3.4 1997 – Project 3

Technical assistance to the BSM in preparing an application to the SEC to become a recognized securities exchange.

Objectives/expected results

The objectives are to:

- 1) assist the BSM in determining its function and role;
- 2) assist the BSM in deciding upon its membership and organizational structure;
- 3) identify appropriate products for trading on the BSM;
- 4) assist the BSM in presenting an application to the SEC to become a recognized securities exchange.

Length of training or assistance

The project should commence following the establishment of the SEC and the implementation of regulations governing the establishment and operation of securities exchanges. The project should be completed within two months of start date.

Estimate of technical assistance required - 2 staff months.

Targeted groups or organizations

The BSM and its members are the targets.

Sequence

The project should commence with a review of the analysis already carried out. Plans should be prepared and discussed with the BSM for the achievement of the objectives and agreement reached on the implementation of these plans. The consultant should then assist in the preparation of an application to the SEC.

Expertise needed for this assistance or training, and suggested sources

A consultancy firm experienced in the development of stock exchanges in emerging markets is required. The consultant should have experience of working in Arab countries. At least one member of the team should have prior experience of either running a securities exchange or of regulating a securities exchange.

Technical Assistance Site (in Lebanon or US)

The work should be done in Lebanon.

Notable differences in perceptions of what is needed or possible

None.

3.3.5 1997 – Project 4

Technical assistance to the Beirut Stock Exchange and the Beirut Secondary Market to prepare a requirements specification for an automated trading system to be operated jointly by the two exchanges.

Objectives/expected results

The objective is to:

Prepare a requirements specification for an automated trading system to be operated jointly by the BSE and the BSM.

Length of training or assistance

The project should commence during the first half of 1997 and be completed within two months of start date.

Estimate of technical assistance required - 4 staff months.

Targeted groups or organizations

The BSE and the BSM.

Sequence

The consultant will be required to produce:

- a project implementation document which addresses the project objectives and business scope of the project;
- a requirements specification for a common trading system to be used jointly by the two markets. This may be used by the markets in the form of a request for proposals to be issued to systems vendors.

Expertise needed for this assistance or training, and suggested sources

A consultancy firm experienced in the procurement or development and implementation of automated trading systems for stock exchanges in emerging markets is required.

Technical Assistance Site (in Lebanon or US)

The majority of the work should be done in Lebanon.

Notable differences in perceptions of what is needed or possible

The BSE may decide to accept PRISM 96. However, because neither the BSE nor the BSM have currently specified their individual requirements, there is a danger that PRISM 96 will not meet either their individual needs or the needs of a combined system. The preparation of a joint requirements specification will assist the BSE and BSM in making a decision on the eventual system which best serves the needs of their respective markets and membership.

3.3.6 1997-99 – Project 5

Technical assistance to the Beirut Secondary Market to establish a commodities, bonds and financial futures exchange.

Objectives/expected results

The objective is to:

Develop the BSM into a commodities, bonds and financial futures exchange.

Length of training or assistance

The project should commence following the approval by the SEC of the application by the BSM to become a recognized securities exchange. The project should be completed within nine months of start date.

Estimate of technical assistance required - 12 staff months.

Targeted groups or organizations

The BSM and its members are the targeted groups.

Sequence

The project should commence with a review of the analysis and the work already carried out.

The consultant should then:

- undertake analyses and research into the viability and timing of a commodities and financial futures market in Lebanon, including detailed research on possible products;
- in consultation with market users, prepare product specifications;
- advise on changes to the rules of the exchange;
- advise on an appropriate organizational and management structure including staffing levels;
- design and implement a program of skills development and education;
- design and implement a market promotional campaign.

Expertise needed for this assistance or training, and suggested sources

This assistance requires a consultancy firm experienced in the development and operation of commodities and financial futures exchanges in emerging markets.

Technical Assistance Site (in Lebanon or US)

The majority of the work should be done in Lebanon.

Notable differences in perceptions of what is needed or possible

The BSM is already receiving some assistance from Arthur Andersen in product identification and has stated its intention of developing into a financial market. However, it may not appreciate the complexities of what is involved and the considerable amount of research and development that is required to establish a market of this nature.

3.3.7 1998-99 – Project 6

Technical assistance to the Beirut Stock Exchange and the Beirut Secondary Market in the acquisition and installation of a new automated trading system to be operated jointly by the two markets.

Objectives/expected results

The objective is to:

Identify and assist in the installation of an automated trading system for the BSE and the BSM which meets the requirements specification prepared under Project 4.

Length of training or assistance

The project should commence following the completion of the requirements specification and once all other conditions on the BSE and BSM warrant the implementation of an automated trading system. The project will involve approximately 5 staff months of technical assistance on the part of the consultant and approximately \$750,000 to \$1,000,000 in hardware, software and communications costs.

Targeted groups or organizations

The BSE and the BSM are the targets.

Sequence

The project should commence with a familiarization of the requirements specification and the preparation of a request for proposals (RFP). The RFP should be sent to no fewer than twelve systems vendors which would be given a period of time to respond. The consultant should undertake an assessment of the responses, advise on the selection of an appropriate system and assist in contract negotiations.

Expertise needed for this assistance or training, and suggested sources

A consultancy firm experienced in the procurement or development and implementation of automated trading systems for stock exchanges in emerging markets is required.

Technical Assistance Site (in Lebanon or US)

The majority of the work should be done in Lebanon.

Notable differences in perceptions of what is needed or possible

The BSE may decide to accept PRISM 96.

Project 4 may determine that the requirements of the BSE and BSM are such that a common system could not be achieved.

3.3.8 1998-99 – Project 7

Technical assistance to MidClear for the acquisition and installation of a centralized clearing, settlement and depository system.

Objectives/expected results

The objective is to:

Specify, select and install a new centralized clearing, settlement and depository system at MidClear.

Length of training or assistance

The project will involve approximately 9 staff months of technical assistance on the part of the consultant and approximately \$750,000 to \$1,000,000 in hardware, software and communications costs.

Targeted groups or organizations

MidClear.

Sequence

- a) Prepare a requirements specification for a centralized clearing, depository and settlement system;
- b) Prepare a request for proposals (RFP);
- c) Issue the RFP to no fewer than twelve systems vendors;
- d) Assess the responses to the RFP;
- e) Advise on the selection of the system;
- f) Assist in contract negotiations.

Expertise needed for this assistance or training, and suggested sources

A consultancy firm experienced in the procurement or development and implementation of centralized clearing, depository and settlement systems in emerging markets is required.

Technical Assistance Site (in Lebanon or US)

The majority of the work should be done in Lebanon.

Notable differences in perceptions of what is needed or possible

MidClear may decide to accept the RELIT system on offer from the French.

3.4 INDICATORS OF EFFECTIVENESS

This section presents indicators to measure the effectiveness and impact of assistance to the BSE and regulatory body(ies).

Intermediate Project

1. Securities Law in place and SEC established;

Project 1

2. The harmonization of all current and new legislation, rules and regulations relating to securities;
3. The adoption of rules for the effective regulation of the securities markets;
4. Completion of training for executives and staff of the SEC;
5. Implementation of procedure manuals and codes of ethics;
6. The establishment of a training course for market participants and the introduction of a securities industry examination;

Project 2

7. Increased numbers of companies applying for listing on the BSE;
8. Increased liquidity;
9. Greater use of the market by domestic investors;
10. The establishment of a research and publications department;
11. Increase in the active membership of the BSE;

Project 3

12. Submission of an application by the BSM to establish a securities exchange;

Project 4

13. Preparation of a requirements specification for an automated trading system to be operated jointly by the BSE and BSM;

Project 5

14. The establishment of a commodities, bonds and financial futures exchange at the BSM;

Project 6

15. The acquisition and installation of an automated trading system for the BSE and BSM;

Project 7

16. The acquisition and installation of a centralized clearing, settlement and depository system at MidClear.

3.5 COMMENT

The following is a comment on the degree to which the US capital market system is transferable to Lebanon.

All Lebanese law is based on the French legal system. However, there is no doubt that both the BSE and the SEC can learn considerably from the experiences of the US securities markets and regulatory systems. Areas of particular note include the US specialist trading system at the American Stock Exchange which could be modified slightly with the objective of increasing liquidity on the BSE. In addition, the Lebanese would learn greatly from the US style of regulation rather than the current model they appear to be working towards which is similar to the regulatory structure in Belgium. US experience in securities analysis, portfolio management, marketing and product selling could also usefully be imparted to brokerage firms.

In establishing the BSM as a commodities and financial futures exchange, the Lebanese could learn considerably from the Chicago Board of Trade (CBOT) which has assisted a number of Eastern European exchanges such as the Warsaw Board of Trade.

Underlying all of this however is Lebanese bank secrecy law which although an undoubted advantage in terms of attracting Arab and other overseas investment, can lead to problems of regulation if not handled properly. Insider trading law in particular should follow the principle of Swiss law.